

# SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Burton Analyst: Norman Catelli Bill Number: SB 640

Related Bills: See Prior Analysis Telephone: 845-5117 Amended Date: July 10, 2003

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** State Agency Contracts/Expatriate Corporations/California Taxpayer and Shareholder Act of 2003

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended June 19, 2003.

☒ FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED June 19, 2003. STILL APPLIES.

☒ OTHER - See comments below.

## SUMMARY

This bill would prohibit the state, absent a compelling public interest, from entering into contracts or agreements with certain publicly traded foreign (non-U.S.) corporations.

## SUMMARY OF AMENDMENT

The July 10, 2003, amendment would change the state agency--from the Department of Corporations to the Secretary of State--that receives an attorney's opinion indicating an entity's financial ability to meet judgments.

## POSITION

Pending.

### Summary of Suggested Amendments

As noted in the analyses of this bill as amended June 19, 2003, and May 7, 2003, amendments are recommended to clarify various definitions used in this bill. Amendments are also needed to resolve a technical issue. The "Implementation Considerations" and "Technical Consideration" from prior analyses are provided below for convenience. Department staff is available to assist the author with amendments.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Legislative Director

Date

Brian Putler

7/23/03

## **IMPLEMENTATION CONSIDERATIONS**

The concept of “substantial business activities” in the place of incorporation plays a significant role in this bill, but the statutory language does not define the concept. The bill lacks qualitative or quantitative standards by which the substantiality of business activity is to be evaluated for this purpose. Since this bill is evaluating foreign corporations, it may be advisable to consider how the United Kingdom and other European tax systems incorporate the concept of “substantial business activities.”

The term “substantially all” referring to the acquisition of a domestic corporation's properties requires a definition. The phrase is not specifically defined in the Internal Revenue Code reorganization provisions, although federal case law and administrative pronouncements have defined it in certain contexts. For example, a corporation's interest expense deduction on debt incurred to acquire another corporation is limited. For this purpose, “substantially all” is defined as 90% of the fair market value of the net assets or 70% of the fair market value of the gross assets. Similarly, for purposes of certain corporate reorganizations or inclusion in a federal consolidated income tax return, “substantially all” is defined as 80% of stock value and voting power. Additionally, in certain corporate reorganizations there is a “continuity of interest” requirement to prevent transactions that resemble sales from benefiting from favorable treatment. For this purpose, 50% of the value of the new stock is to be received by the former owners to receive the favorable treatment.

The provision relating to the stock of the new parent held by former shareholders or partners requires clarification. In an effort to avoid being classified as an “expatriate corporation” the former owners may receive securities other than common stock, thus keeping the 50% ownership threshold from being met. Some securities that may be used to avoid the expatriation threshold are convertible debt, tracking stock, and exchangeable stock.

Subparagraph (A) of paragraph 1 of subdivision (b) contains the phrase “. . . the public trading of the foreign incorporated entity.” This phrase probably should be modified to refer to “. . . the public trading of stock of the foreign incorporated entity.”

## **TECHNICAL CONSIDERATION**

This bill would add Article 11 to Chapter 1 of Part 2 of Division 2 of the Public Contract Code. This new article would prevent certain foreign corporations from being awarded state contracts for public works, goods, or services. The existing provisions of Chapter 1 relate to contracts for public works. However, the provisions of Chapter 2 relate to contracts for goods and services. Consequently, this bill would add language regarding contracts for goods and services (Chapter 2) into the chapter relating to contracts for public works (Chapter 1).

## **LEGISLATIVE STAFF CONTACT**

Norman Catelli  
Franchise Tax Board  
845-5117  
[Norm.Catelli@ftb.ca.gov](mailto:Norm.Catelli@ftb.ca.gov)

Brian Putler  
Franchise Tax Board  
845-6333  
[Brian.Putler@ftb.ca.gov](mailto:Brian.Putler@ftb.ca.gov)